TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Dear Sir or Madam:

This is in response to your letters of September 18, 2002, which raise a number of questions with regard to organizations described in section 501(c)(7) of the Internal Revenue Code. You have raised these questions generally and not in the form of a ruling request on specific facts with regard to a specific organization.

The Service will provide an "information letter" where we are able to call attention to a well-established interpretation or principle of tax law without applying it to a specific set of facts. See, section 3.6, Rev. Proc. 2003-4 IRB 2003-1, 123. To the extent we believe the resolution of a question you raised is sufficiently clear, we have addressed it below. We have also referred your correspondence to our Technical Guidance & Quality Assurance staff who participate in setting the guidance agenda for their consideration in drafting future guidance.

1. You asked: Can a 501(c)(7) tax-exempt membership organization "advertise" to the general public that memberships in the club may be available to qualified applicants?

You cited Rev. Ruls. 65-63 and 60-324, and referred to Spokane Motorcycle Club v. United States, 222 Fed. Supp 151 (1964). In these situations, public patronage or attendance at events was solicited by advertising. In Rev. Rul. 65-63 it was found that "solicitation of public patronage of activities, by advertising or otherwise, is prima facie evidence that the club is engaged in business and is not being operated exclusively for pleasure, social or recreational purposes." The ultimate issue in these situations was a determination of whether there was an operation of a business. The nature of the advertising, solicitation or availability of facilities or attendance was one factor in that determination. There is not a per se rule on advertising for participation, availability or membership. The form and nature of the advertising for members may well be permissible given the nature of the social club and its activities and operations.

2. You asked: Can a 501(c)(7) tax-exempt membership organization "advertise" to the general public for public patronage or participation in club activities by nonmembers, as long as the nonmember income does not exceed the 15/35% limitations?

You cited the above Rev. Ruls. and the Spokane case. Here, as well, we believe the form and nature of the advertising and the nature of the social club and its activities and operations must all be considered. We would caution, however, that the 15/35% rule is a reaffirmation of the principle that nonmember use should be insubstantial and that the club would be obligated to keep exact records of use of its facilities and make appropriate allocations.

3. You recommend that the IRS provide clear guidance as to the definition of "gross receipts" to be used in the computation of the 15% limitation on nonmember income. You state there are two schools of thought. One school of thought is that "gross receipts" includes investment income for both computations. The second school of thought is that investment income is excluded from the 15% limitation computation.

In both computations investment income must be included in the denominator along with member and non-member income. For the 35% computation, investment income and non-member income should be in the numerator. For the 15% test non-member income alone is in the numerator.

As regards non-traditional income of a section 501(c)(7) social club, all non-traditional income must be included in the numerator and denominator even if it is member income. See, Continuing Professional Education Exempt OrganizationsTechnical Instruction Program for FY 1996, Topic C. Social Clubs - IRC 501(c)(7), pgs. 74, 82.

4. You recommend that the IRS permit membership organizations that qualify for tax exemption under section 501(c)(7) of the Internal Revenue Code to form taxable subsidiaries. The for-profit subsidiary would offer the club's facilities for non-member usage. The section 501(c)(7) club would receive income in the form of dividends which would not be included in the numerator for purposes of the 15% computation.

Rev. Rul. 68-74 concludes that activities and operations of a wholly owned subsidiary are considered to be those of the club for the purpose of determining whether the club is engaging in business with the general public for profit. The Rev. Rul. states:
"A club may not insulate itself from the effect of business activities carried on with the general public by forming a subsidiary corporation." Essentially you are asking to revoke or obsolete this Rev. Rul. and have posed a number of related interpretative questions.

Your recommendation and questions are beyond the scope of this information letter. However, we note that PLRs 8528082 and 8208004 and GCM 39397, dated 8/13/85 all follow Rev. Rul. 68-74 and were issued subsequent to the 1976 amendments to section 501(c)(7).

5. You request further guidance regarding the section 337 tax to be paid by a newly formed corporation that is attempting to become a section 501(c)(7) tax-exempt organization. You pose a number of related interpretative questions.

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Interpretative jurisdiction for section 337 issues is in the Office of Chief Counsel, Corporate Division. Accordingly, it would be inappropriate for us to respond here. Also, we believe the interpretative nature of these questions is beyond the scope of our "information letter" procedures.

This letter is advisory only and has no binding effect on the Internal Revenue Service. The information provided here cannot be relied upon as a ruling on the matters discussed. If you have any questions regarding this discussion or we can be of further assistance, please feel free to call David Daume at the number indicated in the heading.

Sincerely,

Gerald V. Sack

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Manager, Exempt Organizations
Technical Group 4